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289-649—68——1

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 897

TRANS WORLD AIRLINES, INC., PETITIONER

v.

CIVIL AERONAUTICS BOARD

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Court of Appeals (Pet. App. C1–C40) is reported at 385 F. 2d 648. The orders of the Civil Aeronautics Board (Pet. App. B, printed separately) involved are E–22022, April 12, 1965 (not yet reported); E–8833, December 20, 1954 (19 C.A.B. 464); and E–10117, March 23, 1956 (23 C.A.B. 307, 312).

JURISDICTION

The judgment of the court of appeals was entered on September 12, 1967. The petition for a writ of certiorari was filed on December 9, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 49 U.S.C. 1486 (a) and (f).

QUESTION PRESENTED

Whether particular aspects of a Civil Aeronautics Board award of subsidy to TWA for operations of its international division from 1946 to 1953, under Section 406(b)(3) of the Federal Aviation Act, are rationally grounded on findings which were arrived at through application of appropriate legal standards and which are supported by substantial evidence.

STATUTES INVOLVED

Section 406 of the Civil Aeronautics Act of 1938 (52 Stat. 973, 998, 49 U.S.C. 486), now Section 406 of the Federal Aviation Act of 1958 (72 Stat. 731, 763, as amended, 49 U.S.C. 1376); Section 168 of the Internal Revenue Code of 1954 (68A Stat. 52, 26 U.S.C. 168); and Sections 1, 2 and 201–205 of the Railway Labor Act (44 Stat. 577 *et seq.*, as amended, 45 U.S.C. 151 *et seq.*), are set forth in Appendix A to the petition.

STATEMENT

Under Section 406 of the Civil Aeronautics Act, the Civil Aeronautics Board is authorized to award two different forms of mail pay to air carriers: (1) "service" pay under clauses 1 and 2 of Section 406(b), which is paid by the Postmaster General as compensation for carriage of the mail; and (2) "subsidy" pay under clause 3 of Section 406(b), which is paid by the Board to promote the development of a sound air transportation system.[1] The instant case involves CAB

[1] See Section 406(c) of the Federal Aviation Act of 1958, 49 U.S.C. 1376(c).

orders determining final subsidy pay[2] for TWA's international operations for the years 1946–1953. The effect of the Board's final determination was to require TWA to refund $2,152,000 of the temporary payments it had received during the years in question.

In July 1946 the Board began a proceeding to establish a final subsidy rate for TWA's transatlantic operations. Shortly before the Board's initial determination in 1954, however, this Court held in *Delta Air Lines* v. *Summerfield,* 347 U.S. 74, that the "need" of the carrier as a whole sets the upper limit on the subsidy rate for any particular phase of its operations. Accordingly, the proceedings were reopened to determine whether the needs of TWA's international division should be offset by the earnings of its domestic division.[3] In 1956 the Board made a further determination in this regard, but this was set aside in 1958 because of a procedural irregularity. *Trans World Airlines* v. *Civil Aeronautics Board,* 254 F. 2d 90 (C.A.D.C.).[4] After further proceedings on remand, the Board entered the order here involved (Pet. App. B1–B62). It took into account its former rulings on issues not reopened on remand, a recomputation of the tax effects of its order, and its resolution of issues concerning certain strike losses and deferred tax

[2] No dispute exists as to the amount of service mail pay ($22,375,000, as against $26,258,000 in subsidy mail pay) to which TWA was entitled for the years in question (see Pet. App. C3).

[3] The proceedings were actually conducted in two parts—the "transatlantic" phase and the "offset" phase.

[4] The court of appeals held that the Chairman of the Board should not have participated because he had been counsel for the Post Office Department during an earlier phase of the case.

accruals claimed by TWA. In sum, the Board held that TWA was entitled to a total of $48,633,000 in international mail pay for the years in question, some $2,152,000 less than the temporary mail pay the carrier had actually received during the 1946–1953 period.

On petition for review the court of appeals sustained the Board on all issues. In its petition to this Court TWA confines its claims to four issues. It contends that the Board erred by refusing to recognize, as forming part of TWA's "need" for subsidy, (1) two-thirds of TWA's losses from a 1953 navigators' strike, (2) TWA's accruals to a book reserve for future termination-of-employment indemnities payable to alien employees under foreign laws, and (3) accruals to TWA's "deferred tax" reserve for future taxes it expected to pay as a result of having taken accelerated amortization under Section 168 of the Internal Revenue Code; and that it also erred (4) in reducing TWA's tax expenses by a portion of a 1946 tax refund which TWA received because of loss carrybacks.

1. *The "Strike Loss" Issue.* Disregarding their contract and the procedures of the Railway Labor Act (45 U.S.C. 151 *et seq.*), TWA's navigators struck for twelve days during 1953, costing TWA $1,003,000. The Board disallowed two-thirds of those strike losses, finding that the obduracy of TWA's management had needlessly prolonged the strike by at least eight days, and that to that extent TWA had failed to comply with the statutory criterion for subsidy assistance—"honest, economical, and efficient management" (Section

406(b)(3) of the Federal Aviation Act, 49 U.S.C. 1376(b)(3)).

The court below agreed with the Board's determination that allowance or disallowance of TWA's strike losses for subsidy purposes hinged not on whether the strike was legal or illegal (the Board agreed it was illegal), but on whether TWA's actions before and during the strike comported with the "prudent management" standard of Section 406. It found ample support in the record for the Board's findings that TWA both contributed to the strike by failure to use all reasonable means to avert a work stoppage, and prolonged the strike by its intransigence in refusing to meet with union officials or discuss reinstatement of the navigators it had discharged. It concluded that the Board had applied appropriate legal standards in assessing the prudence of TWA's management actions (Pet. App. C11).

2. *The "Termination Indemnities" Issue.* The laws of certain foreign countries in which TWA operates require employers to pay "termination indemnities" (*i.e.,* severance pay), based upon past wages and years of service, to all employees hired in those countries who die, retire, or are discharged other than for cause. Unlike the social security laws of this country, however, these laws make no provision for any advance creation of a fund to cover the future termination payment liability, in the form of either social security taxes, payments into a trust fund, payments to an insurer, or any other way of setting aside an amount of current cash.

TWA reported as operating expenses the termination payments it actually made to discharged, retired, or deceased employees during the period 1946–1953, and these were allowed for subsidy purposes without question. Beginning in 1950, it also began accruing on its books a reserve for future termination payments to its existing employees, on the assumption that they would neither resign voluntarily nor be discharged for cause, and sought recognition for these accruals as a current operating expense for subsidy purposes. Reversing its examiner, the Board concluded that these accruals, even if constituting sound accounting practice, were not part of TWA's 1946–1953 "need" for subsidy purposes because they represented sums which had not yet been paid out or set aside, might never be paid out, or might be paid out only at a time when TWA would be self-sufficient and would thus have no need for subsidy reimbursement.

The court below agreed that the propriety of TWA's accruals, as sound general or tax accounting procedure or for standard commercial ratemaking purposes, did not govern their treatment for subsidy purposes. It thus ruled that the Board had properly refused to provide public financing of such "expenses" not actually disbursed during the subsidized period under review (Pet. App. C17–C21).

3. *The "Accelerated Amortization" or "Deferred Tax" Issue.* During the years 1951–1953 TWA purchased certain flight equipment and ground facilities for use in its domestic operations which qualified as "emergency facilities" under Section 168 of the In-

ternal Revenue Code (26 U.S.C. 168).[5] TWA took accelerated amortization on these assets in its tax returns, so that its actual tax payments for 1951–1953 were some $3,110,000 less than if it had used ordinary straight-line depreciation. TWA put $2,990,000 of this tax reduction on its books as "deferred taxes," charging operating expenses and crediting a reserve set up for this purpose, on the theory that these taxes had not really been cancelled but would have to be paid in later years, after the assets in question were fully amortized.

Under its "actual tax" policy in subsidy cases, the Board refused to recognize the "deferred tax" accruals for subsidy purposes. It held that such recognition was forbidden by the "need" provision of Section 406. Since these accruals represented taxes which were neither paid nor payable on 1946–1953 income and would be payable only at some indefinite time in the future, if at all,[6] when TWA would either have no current subsidy need or would have a need which would include the actual taxes then paid, the Board

[5] Section 168 (formerly Section 124A of the Internal Revenue Code of 1939) was enacted in 1950, during the course of the Korean War. It allows any taxpayer who invests in a new productive asset qualifying as an "emergency facility" to amortize its cost for tax purposes over a period of 60 months instead of over the asset's longer useful life, thus encouraging private investment in defense-related facilities.

[6] At the time of the Board's decision in 1964, because of operating losses in 1956–58 and 1961–62 and loss carry-backs and carry-forwards, TWA had not yet paid a single dollar of the added taxes which the reserve was set up to cover.

determined that TWA had not shown a "need" during 1946–1953 for reimbursement of its accruals to this reserve. Nor, it held, was TWA being "penalized" for having elected to take accelerated amortization in its unsubsidized domestic division, for the resulting reduction in its international subsidy stemmed from this Court's subsequent decision in the *Delta* case that domestic earnings must offset international losses in order to determine "need" as a whole.

The court of appeals agreed with the Board (Pet. App. C31–C37), finding the Board's action consistent with its long-standing and judicially sanctioned "actual tax" policy in subsidy cases. It found no conflict with the statutory purposes of the tax provision, and observed that it would require an explicit congressional directive to set aside the "need" limitation of Section 406 (Pet. App. C36).

4. *The "1946 Tax Refund" Issue.* Under its "actual tax" policy the Board also took into account, in determining the domestic division's tax expenses for "need" purposes, a $2,623,000 tax refund received by TWA in 1946 under the loss carry-back provisions of the Internal Revenue Code because of large losses it sustained in that year. TWA argued that since some $129,000 of this refund was attributable to expenses which were not being recognized for subsidy purposes under the "prudent management" standard,[7] that much of the refund should not be used to reduce TWA's tax expenses for subsidy purposes. However, the Board based its determination on the total amount of taxes

[7] This figure is disputed; TWA claims that it is $450,000. These expense disallowances are not themselves being challenged.

actually paid, reducing that figure by the entire tax refund.

The court below agreed with the Board, finding its handling of this issue an appropriate implementation of the "need" requirement of Section 406 as interpreted by this Court and the lower federal courts. The court found no reason for the Board to remain oblivious to the fact that "the public fisc has already been drawn on to provide to the carrier that made excessive expenditures a (tax refund) payment" (Pet. App. C40).

ARGUMENT

In the instant case the Civil Aeronautics Board has authorized payment to TWA of only so much of the public's monies as it actually needed during the 1946–1953 period, considering its revenues from all sources, to enable it "under honest, economical, and efficient management" to maintain and develop its international service. This is the standard laid down in *Delta Air Lines* v. *Summerfield,* 347 U.S. 74, and *Western Air Lines* v. *Civil Aeronautics Board,* 347 U.S. 67. Here the Board was not, as in commercial ratemaking, engaged in arbitrating between the interests of the carrier and its users. Rather, in the words of the court below, it was exercising "a primary duty to the taxpayers, to pay out no more in subsidy than is currently needed to accomplish the purposes of Section 406" (Pet. App. C34). After exhaustive and comprehensive proceedings the Board has actually increased TWA's subsidy some $6 million over its earlier rulings. The court of appeals has thoroughly reviewed the extensive record and has written a lengthy and lucid opinion analyz-

ing and disposing of every contention here made by TWA. No general or continuing importance attaches to the case. Trunkline carriers of TWA's class have not received a subsidy for many years, and no one foresees a return to that situation.[8] Moreover, in view of this Court's *Delta* decision in 1954, the Board no longer determines subsidy rates for carriers like TWA on a divisional basis. The ruling below is correct, and there is no conflict of decisions. Further review by this Court is thus not warranted.

1. *The "Strike Loss" Issue.* TWA attacks both the Board's findings of fact and its ultimate conclusion that the 1953 navigators' strike was needlessly prolonged by imprudent management actions. The Board found as a fact, on a detailed record, that TWA could have achieved as favorable a settlement after four days of the strike as it did after twelve, had it not intransigently refused to meet with union officers or discuss reinstatement of the discharged navigators. There is no reason for this Court to review this factual determination, which has already been thoroughly scrutinized by the court of appeals.

Contrary to TWA's contention (Pet. 45) the Board did not hold that TWA should have appeased the illegal strikers; nor, as a fair reading of its opinion will show, was it prejudiced against the carrier. A simple comparison of the Board's opinion (Pet. App. B8–B14) with the court of appeals' discussion of this

[8] Annual Report of the Civil Aeronautics Board, p. 81 (1967). Only local service carriers remain on subsidy, and most of them are now paid under a system of "class rates" which are set prospectively on a group basis and involve none of the problems of retrospective determination presented here.

point (Pet. App. C6–C11) shows that the court did not rely on grounds factually different from those the Board adopted.

Nor does the Board's decision erode the policy of the Railway Labor Act against wildcat strikes. There is not the faintest indication that Congress ever meant to implement this policy by having the public treasury bear the cost of such strikes, whether suffered by subsidized or unsubsidized carriers,[9] through disregard of the "prudent management" standard of Section 406. See *American Overseas Airlines* v. *Civil Aeronautics Board,* 254 F.2d 744 (C.A.D.C.).

2. *The "Termination Indemnity" Issue.* TWA argues that because it was sound bookkeeping for it to set up a reserve for "termination indemnities," the Board was required to reimburse its accruals to this book reserve with cash subsidy. But the purpose of subsidy under Section 406 is not to assure a subsidized carrier of any particular level of "true income," in the accounting sense, during the period before it achieves self-sufficiency.[10] Cf. *American Overseas Airlines, supra,* 254 F. 2d at 750; *Delta Air Lines* v. *Civil Aeronautics Board,* 280 F. 2d 636, 640 (C.A.D.C.). Rather, the aim is to develop a sound air transportation system by helping initially unprofitable carriers over the threshold to self-sufficiency as rapidly as pos-

[9] Here TWA chose to bargain away whatever remedies it may have had, as an employer injured by an illegal wildcat strike, by settling the dispute.

[10] Cf. *Capital Airlines* v. *Civil Aeronautics Board,* 171 F.2d 339, 340 (C.A.D.C.), certiorari denied, 336 U.S. 961.

sible at the lowest cost to the public fisc consistent with the purposes of the Act. As the court below stated; "If part of the burdens that an unsubsidized company might shoulder today can be so disposed as to come to rest on the applicant for subsidy, after it becomes self-sufficient, rather than on today's taxpayers, that is entirely in accordance with the contemplation of the statute" (Pet. App. C34).

Subsidies are paid in cash and their basic purpose is to cover *current* cash outlays (or amortization of past cash outlays) by the carrier. A reserve for a *possible* future expense, however sound from an accounting standpoint, does not ordinarily call for current subsidy reimbursement. Cf. *Brown* v. *Helvering*, 291 U.S. 193. Only in a limited class of special circumstances, not presented here, have exceptions to the foregoing rule been made.[11]

[11] TWA's statement (Pet. 40) that the Board currently grants a subsidy for voluntary accruals to provide for employee pensions is incorrect. The subsidy rate order cited by TWA has been superseded, and the currently effective order (No. E–25162, May 17, 1967) has no comparable provision. The amendment to the accounting regulations referred to by TWA was adopted only after the cited subsidy order had been superseded. The cited portion of this superseded order dealt not with basic subsidy computation but with "profit-sharing," a peculiar hybrid; moreover, it made no specific mention of pension accruals, but simply provided that, with specific exceptions, expenses should be computed for "profit-sharing" purposes in accordance with the Board's general accounting regulations. Finally, we are informed that most if not all pension plans actually in force among the affected carriers provide for funded reserves, whereby funds are actually set aside and turned over to a bank or other trustee, or put under the control of an independent pension committee. TWA's termination indemnity accruals, in contrast, were not funded in any way.

Since no cash was paid out or set aside during the subsidy period, TWA's termination indemnity accruals did not qualify under this rule or its exceptions. Unless TWA terminated its foreign operations or engaged in mass discharges without cause in the countries in question—both exceedingly unlikely events—the reserve would never be drawn down to zero; on the contrary, as TWA expanded its operations, the reserve would most probably continue to grow indefinitely. Thus, TWA was essentially asking the Board to establish with subsidy a capital fund for its permanent use. Since the Board reasonably determined that these accruals constituted no part of TWA's "need" during the subsidy period, it properly refused to include them in the subsidy calculation.

3. *The "Accelerated Amortization" Issue.* TWA's election to take accelerated amortization on certain defense-related "emergency facilities," under Section 168 of the Internal Revenue Code, reduced its taxes for the years 1951–1953 by $3,110,000. Under *Delta* and *Western,* it was incumbent upon the Board to take into account the effect these tax reductions had on TWA's "need" for subsidy during that period.[12]

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[12] *Delta Air Lines* v. *Summerfield*, 347 U.S. 74; *Western Air Lines* v. *Civil Aeronautics Board*, 347 U.S. 67, affirming 207 F. 2d 200 (C.A.D.C.). The court of appeals in *Western* explicitly upheld the Board's "actual tax" policy (207 F. 2d at 206); and see *Federal Power Comm'n* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 244–245. Compare *North Central Airlines* v. *Civil Aeronautics Board*, 363 F. 2d 983 (C.A.D.C.), where Congress was held to have required a departure from the "actual tax" principle in dealing with the investment tax credit by express language addressed to all regulatory agencies (Revenue Act of 1964, Sec. 203(e), 78 Stat. 35, 26 U.S.C. 38 note).

The basis for TWA's claim is that, while Section 168 allows the taxpayer greater-than-normal deductions in the first five years of the qualified asset's life, it loses the right to take normal depreciation deductions thereafter. This ordinarily results in tax increases during the balance of the asset's life, which increases may or may not be equal in the aggregate to the tax reductions of the first five years.[13] Loss years, carry-backs, and carry-forwards affect the timing of these compensating tax increases; thus, at the time the Board decided this case in 1964, TWA had not yet paid a single dollar of the anticipated tax increases for which its reserve was supposed to provide. When these increases occur, if they do, they will be taxes of 1967, 1968, and later years, not "deferred" taxes of 1951–1953. They will increase TWA's "need", if any, for the future period, but will not retroactively affect the "need" for those earlier years.

TWA nevertheless insists that "normalization" of taxes is required to "accommodate the policy" of the tax statute. In commercial rate cases, the Board does in fact depart from the "actual tax" policy and allows "normalization".[14] However, it does so as a matter of discretion and on policy grounds, not because "nor-

[13] An inequality may result from (a) changes in the tax rates (several of which have occurred since 1950), (b) bankruptcy of the taxpayer, or (c) operating losses which cannot be offset against taxable income of other years.

[14] *General Passenger-Fare Investigation*, 32 C.A.B. 291, 326.

malization" is mandatory. While a 1955 decision[15] upheld "normalization" as proper in commercial rate cases, more recent holdings have sustained agency refusals to "normalize" as proper exercises of administrative discretion not inconsistent with the intent of the tax statute.[16] In any event, such rate cases are not relevant here, since this Court made clear in *Delta* and *Western* that the Board cannot depart from the strict "need" and "all other revenue" standards of Section 406 to accommodate other policies, absent a specific congressional directive.

TWA complains that the Board's decision leaves it worse off than if it had never elected to use accelerated amortization.[17] But this is true whenever a subsidized carrier defers an expense until after it achieves

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[15] *City of Detroit* v. *Federal Power Comm'n.* 230 F. 2d 810 (C.A.D.C.), certiorari denied, 352 U.S. 829; but see *Panhandle Eastern Pipe Line Co.* v. *Federal Power Comm'n.* 316 F. 2d 659 (C.A.D.C.) (*en banc*), certiorari denied, 375 U.S. 881.

[16] *Alabama-Tennessee Natural Gas Co.* v. *Federal Power Comm'n*, 359 F. 2d 318 (C.A. 5), certiorari denied, 385 U.S. 847; *City of Chicago* v. *Federal Power Comm'n.* 385 F. 2d 629 (C.A.D.C.); *Midwestern Gas Transmission Co.* v. *Federal Power Comm'n*, Nos. 15,941 *et al.* (C.A. 7, decided January 5, 1968). While these cases all arose under Section 167 (liberalized depreciation) rather than Section 168 (accelerated amortization), the two provisions are similar in their operation, and the exhaustively researched opinion in *Alabama-Tennessee* makes it clear that no valid distinction can be drawn between them in this regard.

[17] It is doubtful whether the "prudent management" standard of Section 406 would permit subsidy reimbursement of expenses which the carrier could reasonably have deferred, or of taxes which it could have reduced by electing an optional tax benefit.

self-sufficiency.[18] In short, the result reached below on this issue is proper and accords fully with the statute.

4. *The "1946 Tax Refund" Issue.* The actual tax expense of TWA's domestic division between 1946 and 1953 was $9,792,000, consisting of $12,415,000 for the years 1947–1953 less a refund of $2,623,000 for 1946 obtained under the loss carry-back provisions of the tax code. In determining TWA's need the Board included every dollar of TWA's actual tax expense. Under its "actual tax" policy, however, it refused to subtract an additional hypothetical tax expense of $129,000 (TWA claims this figure is $450,000) which *would* have been incurred *if* TWA had not made certain expenditures in 1946. TWA claimed this hypothetical tax expense because the Board had disallowed these same expenditures for subsidy purposes under the "prudent management" test, and hence, it was asserted, ought to ignore the portion of the tax refund for which they were responsible.

The Board did not treat TWA's imprudent expenditures as non-existent, but simply held them ineligible for subsidy reimbursement under the standards of Section 406. Having done so, it refused, in the tax aspect of the case, to indulge in the fiction that the expenditures had not occurred and that TWA's tax

[18] On the other hand, a carrier which took accelerated amortization while off subsidy, and which later went back on subsidy at a time when its taxes were higher as a result, would benefit by the Board's "actual tax" policy, assuming no lack of prudent management. (Several small carriers have in fact gone back on subsidy after being off, although the hypothetical situation described seems never to have occurred.)

expense for the "offset" period was therefore greater than it actually was.[19]

The Board's refusal to allow hypothetical tax increases as offsets against expense disallowances was stated long ago in the *Western-Inland* case, and was explicitly affirmed on appeal in that case.[20] The only factual distinction is that the carriers in *Western-Inland* wanted the Board to recognize a hypothetical additional tax on top of the actual taxes paid, while here TWA wanted the Board to ignore part of its actual tax refund for 1946. The governing principle is identical, and accords with the policy of Section 406 (see Pet. App. C39–C40).

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[19] If the Internal Revenue Service had disallowed these same expenditures, of course, TWA's 1946 tax refund would have been less and its net 1946–1953 tax expense greater, and the Board would have adjusted its subsidy accordingly.

[20] *Western-Inland Mail Rate Case*, 14 C.A.B. 201, 243, 251–255, affirmed on this issue *sub nom. Summerfield* v. *Civil Aeronautics Board*, 207 F. 2d 200, 206 (C.A.D.C.), affirmed *sub nom. Western Air Lines* v. *Civil Aeronautics Board*, 347 U.S. 67. While this Court's decision did not explicitly touch on this issue, the result follows inevitably from the *Western* and *Delta* holdings.

CONCLUSION

For the reasons stated, the petition for certiorari should be denied.

Respectfully submitted.

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